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In the

Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1771

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

STANDARD LIFE & ACCIDENT INSURANCE COMPANY,
Respondent.

REPLY BY RESPONDENT TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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Respondent Standard Life & Accident Insurance Company submits this reply to the petition by the Solicitor General, on behalf of the Commissioner of Internal Revenue, for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

Respondent takes the position that a writ of certiorari should be granted in this case and that the decision of the Court of Appeals for the Tenth Circuit should be affirmed by this Court.

STATEMENT

Respondent is a life insurance company subject to federal income taxation under provisions of the Internal Revenue Code of 1954, as amended, that govern the

taxation of life insurance companies. These particular taxation provisions exist because of the need properly to determine the taxable income of a life insurance company resulting from its insurance premiums and investment income and the company's obligations to maintain insurance reserves required by state laws.

The issues presented in the Petition in this case concern the treatment for federal income tax purposes of unpaid premiums on insurance policies in force at the end of a life insurance company's tax year.[1] Such unpaid premiums arise when insurance premiums are paid in installments rather than fully at the commencement of the policy year and also when, at the end of the tax year, there are outstanding policies that have been extended under "grace period" provisions even though the premium for such period has not been paid.[2] With respect to all the unpaid premiums under discussion, there is no legal requirement that the policy holder or any person pay such premiums; if the premium is not paid, the only consequence is that the life insurance policy will lapse after a specified period.

The Court of Appeals for the Tenth Circuit held that respondent's unpaid premiums at the end of its 1958, 1959 and 1961 tax years were properly excluded from respondent's premium income for such years and were properly excluded from respondent's assets for

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[1]Respondent does not necessarily agree with the petitioner's phrasing, at page 2 of the Petition, of the question presented in this case. Respondent believes that the primary question presented is what is the proper treatment of unpaid premiums in computing the federal income tax liabilities of life insurance companies and that a subsidiary question concerns the proper treatment of life insurance reserves for policies as to which there are unpaid premiums.

[2]Use of the term "unpaid premiums" for the premiums in question follows the terminology used by the Tenth Circuit in the opinion below. What are here termed "unpaid premiums" are termed "deferred and uncollected permiums" in the Petition (see Petition 4 at n.1).

purposes of computing federal income tax liability. The fundamental reason for such holding was that for each tax year in question respondent had not received unpaid premiums and had no right to receive such premiums. The Court of Appeals rejected the argument of petitioner that the treatment of reserves on policies with respect to which there were unpaid premiums required a contrary result. As to these reserves, the Court of Appeals noted that life insurance reserves are computed on the assumption that unpaid premiums will later be paid and such reserves are required by applicable state law (a fact that brings these reserves squarely within the definition of life insurance reserves in section 801(b) of the Internal Revenue Code); the court went on to hold that calculation of life insurance reserves for policies as to which there were unpaid premiums does not alter the fact that respondent had not received, and had no right to receive, such unpaid premiums at year end.

Respondent submits that the decision of the Court of Appeals for the Tenth Circuit on these issues is clearly correct.

However, respondent does agree with that portion of the Petition indicating that the question of the proper tax treatment of unpaid premiums is of great importance to the life insurance industry. This question arises with respect to virtually every mutual or stock life insurance company. From the enactment in 1959 of the basic tax provisions presently applicable to life insurance companies, the proper treatment of unpaid premiums has been an unsettled question with important impact on the tax liabilities of life insurance companies. Uncertainty as to tax treatment is particularly troublesome for life insurance companies in that it substantially impedes effective long-range financial planning. In respondent's view, the need to settle definitively this long-standing uncertainty justifies review by this Court of the Tenth Circuit's decision in this case.

Respondent also agrees with petitioner that review of this case is justified by the existence of a conflict between the decision below and decisions of other Courts of Appeals. Decisions by four other Courts of Appeals have dealt with questions of the inclusion of unpaid premiums in premium income and assets for purposes of computing tax liability — *Franklin Life Insurance Co. v. United States*, 399 F.2d 757 (7th Cir. 1968), cert. denied, 393 U.S. 1118 (1969); *Jefferson Standard Life Insurance Co. v. United States*, 408 F.2d 842 (4th Cir. 1969), cert. denied, 396 U.S. 828 (1969); *Western National Life Insurance Co. of Texas v. Commissioner*, 432 F.2d 298 (5th Cir. 1970); and *Western and Southern Life Insurance Co. v. Commissioner*, 460 F.2d 8 (6th Cir. 1972), cert. denied, 409 U.S. 1063 (1972). In each of these cases, the Court of Appeals has taken the position that all unpaid premiums should be included in premium income and assets. It should be noted that these decisions are focused primarily on a portion of unpaid premiums called "loading", which is that portion of unpaid premiums that is not required to cover the bare actuarial cost of insurance; however, in deciding that "loading" on unpaid premiums should be included in premium income and assets, the Courts of Appeals in these cases required inclusion of the entire amount of unpaid premiums in premium income and assets. The Tenth Circuit decision that no part of unpaid premiums is includible in premium income or assets is squarely in conflict with these earlier decisions.[3]

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[3]In connection with this case, this Court should be aware of an additional line of cases in which Courts of Appeals have held that agents' commissions relating to unpaid premiums should be deducted in computing premium income (such agents' commissions are normally equal to a substantial part of "loading"). See Great Commonwealth Life Insurance Co. v. United States, 491 F.2d 109 (5th Cir. 1974); Federal Life Insurance Co. v. United States, 527 F.2d 1096 (7th Cir. 1975); and North American Life and Casualty Co. v. Commissioner, 533 F.2d 1046 (8th Cir. 1976).

Because of the importance to the life insurance industry and to federal tax administration of settling the issues presented in this case and because of fundamental conflicts between the decision below and the decisions of four other Courts of Appeals, respondent believes that this Court should grant a writ of certiorari to review the decision of the court below in this case.

CONCLUSION

For the reasons stated above, respondent asks that a writ of certiorari be granted in this case and that the decision of the Court of Appeals for the Tenth Circuit in this case be affirmed by this Court.

Respectfully submitted,

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